

CONCEPT PAPER ON IMPROVING GOVERNANCE THROUGH POLICY-BASED LENDING (PBL)

Robert Myers, October, 2003

I. Introduction

1.1 The purpose of this concept note is to provide substantive underpinning to some soon-to-be-prepared Guidelines for The African Development Bank (AfDB) for Governance Policy-Based Lending (PBL). The aim of such lending is to improve governance and through this economic development and poverty alleviation. PBL is untargeted: it goes to government treasuries for use on any government expenditures whatsoever. It is disbursed only after governments undertake policy initiatives that are specified by the lender (Donor) as conditions of the lending operation. Improvements in governance are therefore expected to come about as a result of **changes/additions to policies and behavioral incentives** rather than as a result of the expenditure of the loan funds. This is different from project lending where the lender (Donor) specifies how the loan funds are to be spent/redirected in order to "buy" or stimulate the changes themselves.¹

1.2 The AfDB has defined its scope of coverage of governance in terms of five issues: Accountability; Transparency; Combating Corruption; Participation; and Legal and Judicial Reform. These five areas provide guidance for the structure of this note. Sub-Section II (General Issues) covers issues relating to governance, generally considered. Following this, there are five Sub-Sections (numbered III through VII) dealing with conceptual matters relating to AfDB's five specific elements of governance. Although these are treated separately, there is considerable overlap and interrelationship amongst all five. At the end of the seventh Sub-Section (on Legal and Judicial Reform) there are six annexes covering technical details of PBLs for governance. Annex 1 presents UNHCR Recommendations Regarding Legal and Judicial Reform in Mexico to show specific reform recommendations. Annex 2 demonstrates the COLLECTING DATA FOR COUNTRY-SPECIFIC PBL ASSESSMENT OF GOVERNANCE. Annex 3 presents Examples of Project Preparation for Governance. Annex 4 presents Major Best Practices Initiatives for Governance-Improving PBLs, organized by the five AfDB sub-categories. Annex 5 presents suggestions on how to mainstream or introduce governance activities into AfDB PBL work.

1.3 This concept paper addresses several issues. The most completely addressed are 1) concerns relating to convincingly showing how better governance improves development prospects and 2) what PBL activities/policy practices, etc. will likely

¹ One of several treatments of the general governance issue is "Governance for sustainable human development." UNDP policy document: United Nations Development Program, January 1997. <http://magnet.undp.org/policy/default.htm> . Good general web sites are: http://www.un.org.pk/undp/eissues_govern/g_overview.html , http://www.usaid.gov/our_work/democracy_and_governance/ , <http://www.worldbank.org/wbi/governance/index.html> , and <http://www.dfid.gov.uk/> .

improve governance and through that, growth in GDP, employment and poverty alleviation. Additional concerns addressed here relate to the institutional growth/changes that coincide with improved governance and with an enhanced AfDB role in this.

II General Issues

2.1 The relevance to better governance of this distinction between policy based and project lending needs elaboration. The rationale for PBL generally is that it improves countries' policy and institutional climates so as to increase the impact or success of newly initiated projects, whether by the public or private sector. Thus, instructions regarding how to design a governance **project** always begin with the admonition that *first an enabling environment must be established through relevant (public sector) institutional and policy reform.*² It is the task of PBL to establish this enabling environment so as to improve the success of newly initiated private and public sector governance projects.

2.2 A Governance and Poverty Alleviating Growth In this note better governance in the economic realm is defined in terms of five elements: **greater accountability and transparency, combating corruption, increased participation and improved laws, judicial systems and access** to same. Improvements in these five areas will enhance productive incentives and job opportunities for all citizens. Better governance makes citizens feel more empowered to freely pursue their entrepreneurial proclivities and better themselves economically. Improved governance liberates "freedom of calling" or the chance for each citizen to pursue his/her economic destiny without suppression by governments and/or monopolies.

2.3 In the economic realm major enemies of good governance and more economic freedom are secrecy, corruption, monopolies and government (particularly uneven/discriminatory) controls, prohibitions, repression, etc. of free expressions of legitimate private productive proclivities. In fact, although freedom *per se* is not a goal of improving governance, greater freedom, at least in certain dimensions must result before better governance leads to faster growth and greater poverty alleviation. Virtually all the quantitative studies relating governance and improved welfare choose one (of several) freedom indices to represent improvements in freedom. Many, including Dani Kaufmann³ use the Freedom House⁴ freedom index which is an agglomeration of political and economic freedoms. Another annual index that focuses more specifically on economic freedoms is produced in a publication entitled "Economic Freedom of the

² For example see the web site regarding designing CDD projects at:
<http://lnweb18.worldbank.org/ESSD/sdvext.nsf/09ByDocName/ProjectPreparationImplementationKeyDesignPrinciples> . Also see ANNEX III of this Note.

³ Dani Kaufmann, "Governance Matters," at: <http://www.worldbank.org/wbi/governance/pdf/govmatrs.pdf>

⁴ <http://www.freedomhouse.org/>

World: 2002 Annual Report" by the Free the World organization that is part of the Fraseer Institute.⁵

2.4 In Africa, coming off of 20 years of socialist economic repression, much of the improvement in governance will consist of reducing and more clearly proscribing government involvement and interventions in the economy so as to allow the productive tendencies of private individuals and households to flourish. For Africa, Mauritius provides a most important example of the interrelationship between growth in GDP and private sector employment on the one hand and improved governance on the other. In essence the Government of Mauritius (GOM) allowed the emergence of an **international business climate**, initially in eight EPZs. Employment (participation), particularly of women,⁶ and the welfare of the lower income quintiles soared. Governance also improved as the impact of the EPZs became evident to public servants. The success was spread throughout the whole economy by making progressively larger areas EPZs and by designating more and more enterprise sub-sectors as "EPZs" no matter where they were located. The key to the simultaneous improvement of governance and GDP growth seems to have been the marked expansion of employment and participation in the formal economy.⁷

2.5 **B** Improved Governance Viewed as Income-Increasing Services A primary ingredient for better governance is more private (or independent of government) economic initiatives (participation) in the effort to improve the five above-listed elements of governance.⁸ These independent economic initiatives represent entrepreneurial efforts to earn or increase household income while providing services that improve governance. Although these income-earning governance services are occasionally provided by individuals, most result from the establishment and growth of non-government, domestically rooted institutions. These Non-Government Institutions (NGIs) are independent of government and more indigenous and dependent on the domestic economy than NGOs. They are like commercial enterprises that provide services rather than tradable output. Their service output has both commercial (for-profit) and social (public goods - non-profit) dimensions.

2.6 It is crucial that PBLs encourage rather than inhibit the emergence and growth in Non-Governmental Institutions (NGIs). Policies should reflect the fact that NGIs are subject to appropriate laws affecting private commercial and non-profit associations, rather than to separate laws, e.g., for NGOs. Non-Government Institutions provide citizens with the freedom of calling or the chance to pursue their entrepreneurial proclivities in the political, social and economic realms. PBLs must not hinder or crowd

⁵ See their web page on the index at: <http://www.freetheworld.com/>

⁶ The high participation rate of women in the (very successful) EPZs caused some to refer to the rapid development of Mauritius as "bedroom led" growth.

⁷ Dani Kaufmann feels that the causality goes from better governance to faster growth. In correspondence with him I've maintained that both improve or worsen together. I consider growth in the numbers of private investors and formal sector employment to be the key to improvements in governance, GDP growth and poverty alleviation. Dani doesn't consider private formal sector employment.

⁸ A most important paper on the relationship between governance and development is Dani Kaufmann, "Governance Matters," at: <http://www.worldbank.org/wbi/governance/pdf/govmatrs.pdf>

out or suppress these NGI proclivities, either by arrogating/designating their functions to the public sector or inhibiting and/or taxing their support revenue. These NGIs should be viewed as providing growth-enhancing inputs in the form of improved governance and, indirectly, a larger tax-base. Archetypal NGIs include think tanks, consulting and lobbying firms, legal services and watchdog institutions and several different types of media firms, including advertising agencies. They are businesses, frequently tax-exempt that provide service output and non-governmental income, recognition and reputations for their staff. However, their success causes significant growth in GDP, tax-bases and government revenue.

2.7 Key policy initiatives for improving governance include breaking up existing monopolies, including foreign owned ones, preventing the formation of new ones and fostering competition at every turn. There should be heavy emphasis on deregulation and reduction of administrative activities that inhibit freedom of entry and exit of (sale of assets to) new investors. Also important would be suppression of distinctions between foreign and domestic enterprises and a renewed emphasis on domestic resource mobilization through expanding the numbers of tax payers and through sales of domestic currency bonds in open asset markets. The domestic economic atmosphere should become particularly favorable to the establishment of new for-profit and non-profit service-providing enterprises.

2.8 **C** The Relationship between PBL and Better Governance Given the importance of NGIs in improving governance, it would appear that project rather than policy-based lending would be the better vehicle for subsidizing improvements to governance. And indeed, improving governance through NGI growth can benefit significantly from project aid. However, in view of Africa's political past, important initiatives for improving governance must involve reigning in, limiting, circumscribing and even policing the behavior of public servants so as to reduce and regularize interventions and allow governance-improving NGIs to flourish. There is a conundrum, however: Policy-based lending raises government expenditures over and above what they otherwise would be thus potentially continuing/increasing capricious interventions and "crowding out."

2.9 The solution to this conundrum involves setting conditions in PBLs that deregulate and delimit government so as to reduce interventions and the breadth or reach of government. At the same time the PBLs should stress the importance of expenditure re-direction to deepen public sector focus on, commitment to and actual (not budgeted) expenditures for, "core" government functions such as policing (including of public sector corruption) fair and comprehensive collection of taxes, education, health, etc. Doing this will leave scope for the expansion of NGIs and better governance.

2.10 **D** Relationship of Informal Activity to Governance Informal activity in Africa is widespread and vibrant, demonstrating failures in formal sector governance. It provides employment and a meager livelihood for over half the citizens in most African countries.⁹ It exists mainly because the actions of governments cater to a select few rather

⁹ Throughout Tanzania it is said to be "like posho." That is, it is as important as the staff of life to them.

than to the majority of citizens. In effect, informal sectors are alternative forms of governance that in most respects are more favorable to economic development and poverty alleviation than the *in situ* formal economies and governments. Vibrant informal activity occurs because participation and entry into formal governments and economies is so difficult and/or costly. Informal activities are not legally constituted or licensed.¹⁰ They are unregulated and don't file for or pay taxes.

2.11 A most important characteristic of the informal economy is ease of entry; it is open to participation by all. The informal economy has shaky legal standing and no direct access to formal sector credit or to imports. Because of the way Central Banks in Africa control credit extended to buy foreign exchange and imports, informal firms can not import directly, but must instead get their imports from formal firms. With exceptions, the output of the informal economy is services.

2.12 Significant evidence of improved governance would be the natural and willful migration of informal into formal economic activity. That is, a measure of actual improvements in formal sector governance would be that informal sector participants voluntarily accept absorption into (reformed) formal sectors.

2.13 **E** Mainstreaming Concerns for Better Governance Over the past twenty years the content and coverage of policy-based lending operations has become relatively standard or "mainstream." This mainstream body of knowledge has enabled the staff of MDBs and their counterparts in governments to converse and negotiate knowledgeably and agree quickly on new PBLs. Although there has been recognition of the significance of problems and shortcomings concerning governance, it is not until recently, within the past three years, that MDBs and client governments have decided that it is necessary to accommodate governance-improving policy reform recommendations within the standard PBL liturgy, or the PBL mainstream. This mainstreaming process involves all aspects of PBL including researching best practices and educating/training both MDB and client government staff about governance issues.

2.14 Mainstreaming requirements bring about the need to consider some fairly extensive changes/additions to AfDB's operations procedures and functions.¹¹ The lesson from the World Bank and USAID is that adding concerns and coverage of governance issues is an extensive process involving adding, reallocating and training some staff to focus uniquely on governance issues and sensitizing many other operations staff to extend their PBL operational functions. These extensions apply both to the substance of their policy recommendations and to the extension of their in-country contacts to a broader set of actors, particularly to many outside of the central government.

2.15 **F** The Use of Foreign Expertise in NGIs The key to the success of governance-improving NGIs is that their professional and entrepreneurial expertise earns income as a result of successfully improving governance. Such expertise is frequently international in character, but with one big anomaly. Overseas experts from developing

¹⁰ Footnote Hernando De Soto's work in Egypt through ECES.

¹¹ These points reflect talks with Dani Kaufmann and Anwar Shaw of the World Bank.

countries tend to work for private NGIs in developing countries, but experts from developed countries tend to work for governments in developing countries. This anomaly must be removed, through growth in developing country NGIs, so that overseas experts also work for private NGIs rather than governments in developing countries. For this to happen, NGIs must be treated as commercial, for-profit or non-profit enterprises so that compensation for NGI expertise is market determined and the stigma against using foreign expertise in allegedly sensitive areas is removed. And, the nascent NGIs must initially receive gifts or subsidies in order to get started.

2.16 **G** Major Assumptions In this note it is assumed that governance-improving PBLs stimulate policy changes that markedly improve African countries' incentive systems so that there is rapid growth, relative to the public sector, in the number of and competition amongst both private, for-profit and non-profit enterprises. It is further assumed that governance-related NGIs will proliferate and compete against one another even while the sector as a whole receives project-type grants and subsidies from first external but later internal Donors and clients. In conjunction with this, it is assumed that foreign and domestic investors and NGI professional expertise will be treated equally and receive income/profit according to private, market rather than public sector terms and conditions. Finally it is assumed that governments will look to rate-neutral expansion of tax bases and greater domestic currency bond borrowing to gather public sector resources, with the expansion of the tax bases coming importantly from liberalization of economic relations between the domestic formal and informal economies.

III. Accountability

3.1 As with all governance issues, accountability can apply to the public and the private sectors. In as much as the focus of this concept paper is on policy based lending (PBL) to governments this section will deal with accountability in the public sector broadly defined. Given the dominance of the public sector in African countries this coverage is significant. Public sector accountability applies to elected/appointed representatives, public officials, government departments, public enterprises and quasi-government bodies. Some specific areas of public sector accountability include: Budgetary Processes, Financial and Social Accounts, Procurement and Contracts, Economic & Financial Regulations, Parliamentary (Public) Disclosures, Auditor General Office Actions and Central Bank Data and Actions.

3.2 Public sector accountability refers to the ability to call public officials and service providers to account, requiring that they be answerable for their policies, actions and use of funds. It plays a significant role in economic incentive systems. Appropriate and active accountability procedures guide and stimulate the work and entrepreneurial efforts of personnel in order to maximize social welfare. The absence of appropriate accountability systems and procedures results in shirking, if not corruption, stifles motivation and initiative and thwarts participation or the transmission of citizen preferences to politicians and public servants. Poor accountability is directly associated with relatively more informal economic activity. Weak/nonexistent accountability principles and practices

thwart more rapid development indirectly, through poor/weak implementation of policies and directly, by reducing productive, responsive and effective work effort.

3.3 At a more macro and statistical level, it has been shown that the greater is institutional accountability, the more robust is economic growth.¹² To measure the extent of institutional accountability, and of the importance of the rule of law and enforceability of contracts, a "Contract-Intensity Money" (CIM) ratio (the ratio of money held in the official banking system divided by total money) is used. This is important because this same ratio helps measure the relative sizes of the formal and informal economies, with a lower ratio meaning relatively more use of currency and a relatively larger informal economy.¹³ Relatively strong rule of law and enforceability of contracts, important indicators of institutional accountability and integrity, are clearly associated with greater use of institutional money (higher CIMs) smaller informal sectors and faster formal economic growth. Another relationship of relevance is that "Free" and "Partly Free" societies benefit relatively more, terms of GDP growth, from greater institutional accountability than do "Not Free" countries.

3.4 Reforming/improving public sector accountability through PBL can be done holistically, e.g., beginning with whole scale assessments. PBLs focussing on the accountability aspects of governance can begin by fostering country acceptance of the International Recognized Standards and Codes (IRSC) as these are set out in: <http://www.imf.org/external/standards/scnew.htm> . The dimensions of financial accountability problems can be ascertained through the use of several diagnostic tools such as the World Bank's Country Financial Accountability Assessments (CFAA).¹⁴ This is a useful exercise, but perhaps too general for formulating actionable conditions for PBL.

3.5 Instead, the accountability process can be broken down into segments, such as those set out in the last sentence of paragraph 2.1 above, and addressed in specific fashion. For instance, probably the most applicable approach to reforming/improving accountability in budgetary processes, including the most up to date information on appropriate public sector financial accounts, is Public Expenditure Management (PEM) which is set out in detail on a World Bank web site, <http://www1.worldbank.org/publicsector/pe/pemanagement.htm> and in the PEM Handbook (<http://www1.worldbank.org/publicsector/pe/handbook/pem98.pdf>). Regarding the social or national accounts, it is best to pick up on the IMF's standards on social and national accounting.

¹² See: "The Role of Institutional Accountability in Economic Development: A Time-Series Cross-Sectional Regression Analysis." Ji-Hyang Jang: <http://www.la.utexas.edu/depts/gov/papers/jang.pdf> .

¹³ Snider, Lewis. 1996. *Growth, Debt, and Politics*. Boulder: Westview Press.

¹⁴ See: <http://www1.worldbank.org/publicsector/cfaa.htm> for the CFAA. Other overall review tools are: Public Sector Review (World Bank), Country Procurement Assessment Review (World Bank), Fiscal Transparency Review (IMF), Diagnostic Study of Accounting and Auditing (Asian Development Bank), Ex Anti Assessment of Financial Management (European Commission) and Country Assessment in Accountability and Transparency (UNDP).

3.6 Regarding government financial and social accounting, first compare with best (see: http://www.adb.org/documents/reports/accrual_budgeting_accounting/chap02.pdf for financial accounts and the various IMF manuals such as the one on Fiscal Transparency.¹⁵ Following this, some detailed examinations of the particular problems and shortcomings will be needed.

IV Transparency

4.1 Transparency involves increasing the flow of information and the public's access to it, primarily about behavior of public servants, politicians and their private sector counterparts with respect to how their actions affect the political and economic aspects of society. Secrecy, confidential classifications, obfuscation, disingenuousness, intentionally misleading, etc. are the opposites of transparency. Given that transparency "in the large"¹⁶ encompasses the other four elements of governance, (i.e., accountability, corruption, participation, and legal and judicial reform) this concept paper will mainly address the secrecy and confidentiality issues in this subsection.

4.2 Increasing transparency involves establishing and pitting the powers of the collective, or the many, against the powers and privileges of the few. There is, therefore, a countervailing power aspect to increasing transparency. There are significant social and economic benefits to greater transparency despite the fact that such increases are frequently privately and selectively costly to the few. In this sense, increasing transparency will almost always involve reducing the powers and privileges of the few in favor of greater welfare of the many.

4.3 Much of the success associated with increasing transparency has involved greater globalization and country adoption of more global governance and information dissemination standards. The idea is to adopt a "lowest common denominator" with respect to what information is withheld as classified secret/confidential and how and how quickly non-classified information is to be made available. It is generally the case that more open and democratic societies make more information available in a more timely fashion. However, greater democracy is by no means a prerequisite or prior condition for greater transparency. If anything, the reverse is true.

4.4 Increasing transparency, or the breadth and timely availability of information on political, administrative and economic behavior, requires both countervailing power and resources. As a general rule the countervailing power has not emerged and the resources have not been forthcoming in Africa. Instead a culture of secrecy and distrust has crept over the continent since the late 1960s. This has been bolstered by a general belief that scarce resources are better spent on social overhead capital and other public sector

¹⁵ See: <http://www.imf.org/external/np/fad/trans/code.htm>

¹⁶ In an important sense the whole governance issue has its origins in the establishment and rise to prominence of Transparency International, an NGI started in 1993 by Peter Eigen primarily to fight corruption. Peter resolved to do something about corruption following retirement from the World Bank and numerous assignments on and in Africa.

investments rather than on more transparency. That is, that only the rich can afford greater transparency.

4.5 This is a complete misunderstanding of the role that greater transparency can play in economic development and poverty alleviation. Greater transparency is an essential ingredient in establishing trust and incentives needed to motivate a development effort from private enterprises and households. Secrecy breeds mistrust and a wait-and-see disengagement amongst citizens. Greater transparency on the other hand brings forth more, more widespread developmental resources and effort. Indeed, expending resources to increase transparency will be rewarded many times over, both in terms of government revenue, development and poverty alleviation if it establishes more trust and familiarity between public servants and their private sector counterparts.

4.6 One key to increasing transparency is to gain publicized agreement on specific goals for reducing secrecy including increasing the scope and volume of information identified as "public" rather than confidential or secret and streamlining and simplifying procedures for freely obtaining it. A second is to provide funds for a larger, more independent apparatus to collect and rapidly disseminate such information.

V Combating Corruption

5.1 "Corruption is the misuse of public office for private gain. It encompasses abuses by government officials such as embezzlement and nepotism, as well as abuses linking public and private actors such as bribery, extortion, influence peddling, and fraud. Corruption arises in both political and bureaucratic offices and can be petty or grand, organized or unorganized."¹⁷ Corruption significantly reduces the pace of economic development and poverty alleviation below what is possible in its absence. It lowers the effectiveness of, sometimes even subverts the intent of policy and can weaken or suspend the rule of law. It can lower the efficiency of government by reducing/distorting public resource flows and the incentives for more productive, socially beneficial behavior by public servants.

5.2 Corruption is mainly financed by private domestic and foreign commercial (enterprise) activity even though its main impact is to suppress such activity well below what it would be without corruption. The absolute volume of corruption financing is limited by private sector activity. Corruption tends to be less, the more there is domestic price competition and vibrancy, especially with respect to employment in the formal private economy. This implies that corruption is enabled by government laws interventions and regulations that are "excessive" in the sense that they limit or frustrate legitimate competitive entrepreneurial proclivities. Grand corruption is usually confined to a few highly placed officials who are outright thieves, deserving political and judicial prosecution.

5.3 Petty corruption can be widespread, insidious and damaging to development and poverty alleviation. It is generally classified as "grease" or "glue" depending on whether

¹⁷ USAID web page: <http://www.usaid.gov/democracy/anticorruption/corruption.html>

the bribes enable or prevent investments that increase GDP. Although grease bribes seem more acceptable, they too are very costly. They significantly raise opportunity costs by lowering productive efficiency, thus slowing actual GDP growth to well below achievable long-run maximums. As one Zambian said, grease bribes are like very slowly setting glue bribes. What is clear is that once "petty" corruption settles in as a way of life, it is very hard to get rid of.

5.4 **A** Corruption and Low Public Sector Pay There is tacit acceptance of broadly distributed or petty corruption as a means of allowing (too many) underpaid public servants to "make ends meet." The reasoning goes that budgetary constraints force public servants to be so poorly paid that they can not live and adequately (productively) perform their public duties without corruption payments. It is certainly true that most public servants in Africa receive abysmally low pay, well below a living wage. However, it is not true that corruption payments, or even higher wages and salaries cause them to perform their jobs any better or more productively. Instead most perform their public sector jobs sporadically, at abysmally low, even negative levels of productivity. For many in Africa their civil service job provides a way of accumulating money through rent-seeking to finance other jobs, frequently in the informal economy. In this all-to-familiar situation, the public sector is viewed as the primary formal economy employer rather than as a (supposedly efficient) provider of public goods and services.

5.5 A vitally necessary condition for reducing widespread petty corruption in this setting is rapid growth in the private formal sector demand for labor and mid-level expertise. This can only happen with an improved atmosphere for both investment and competition. This involves both deregulation and anti-trust -- to ease investor entry -- and a paring down of the purview and responsibilities (the "reach") of government so as to allow significant initial reductions in the size of the public workforce. So far there has been scant success in Africa with the civil service reform part of this effort, primarily because there is a wide-spread belief that the private formal sector will only generate increased employment with *more* not less government interventions. Such beliefs fit hand-in-glove with more corruption.

5.6 Corruption can flourish when there is weak, fuzzy demarcation between political/administrative discretion on the one hand and commercial laws and regulations on the other. Things are particularly bothersome when judiciaries are not independent of and/or weak or underdeveloped relative to political/administrative systems. In these situations bribes can effectively gain unequal, excessively favorable treatment of a few investors over their potential competitors.

5.7 One approach to reducing corruption is to clearly define corrupt actions and to establish anti-corruption police/legal units to prosecute transgressors. This can be very expensive per culprit, but initial successes can dramatically reduce grand corruption and help significantly in establishing the independence of the judiciary. There is currently a considerable Donor effort to gain global agreement on definitions of corrupt behavior and to diagnose the circumstances in each country. The World Bank has an excellent web site

on how to define and diagnose corruption.¹⁸ There are also moves to get multinational companies to sign international agreements to eschew financing corruption. This has merit, but tends to identify corruption as involving mainly foreign direct investment (FDI), which is misleading. Less attention is being paid to the establishment of country anti-corruption police/legal units, partly because it is argued that the domestic investment volumes don't warrant such expenditures. This too lacks sophistication. When corruption is not a problem, the playing field is truly level and there is great ease of entry and exit, most societies, even very poor ones, can experience significant growth in investment, employment and GDP.

5.8 Another suspect approach is to simply raise wages and salaries of public servants in theory to both "buy off" petty corruption behavior and raise civil service productivity. This rarely works without ancillary reforms that accomplish two things. One is to reduce (sometimes dramatically, as needed in Egypt & Nigeria) public sector employment and sharpen the focus of the public sector so that civil service productivity is easier to measure. The other is to experience rapid growth in formal private sector employment. This reduces the "employer-of-last-resort" role of government and strengthens the interdependency between public and private sector professionals.

VI Participation

6.1 **A** Allow Stakeholders to Coalesce and Have Roles in Policy-Making
Amongst Donors, participation tends to be defined in terms of a focus on aid projects or programs.¹⁹ Policy based lending (PBL), on the other hand tends to address countrywide social and macroeconomic policy issues. These latter issues are generally the purview of business/commercial/farming, etc. coalitions/associations who have a large stake in the policies chosen. Not infrequently these non-government views are expounded by professionals in NGIs such as Think Tanks. Increasing participation in PBL policy making and lending activities increases ownership and policy effectiveness. It requires establishing involvement entitlements and precedents ("places at the table") for allowing these NGIs a voice in policy formulation and in how the cost implications of these policy changes are to be shared/financed.

6.2 At independence most African countries had many privately formed, financed and managed business and farming organizations and associations (NGIs) that formulated policy positions and lobbied governments to adopt these policies to enhance their welfare. Two (of many) examples would be the Kenya Farmers Association (KFA) and the Zimbabwe Association of Manufacturers (ZAM). During the "socialist 70s" the private, self-interested nature of these NGIs was diluted/neutralized, partly on racial grounds, but mainly to reflect increased government involvement in the ownership and management of domestic commercial activity. The dilution/neutralization of the private, self-interested nature of these NGIs was mainly accomplished by the judicious placement

¹⁸ See: <http://www1.worldbank.org/publicsector/anticorrupt/diagnostictools.htm>

¹⁹ See the World Bank participation web site (<http://www.worldbank.org/participation/>) or <http://www.civicus.org/new/default.asp>

of government personnel on their Boards and Management Committees who were "the greater of two equals."

6.3 The result was that these NGIs became policy toadies to governments (i.e., government institutions) rather than stakeholders who independently advocate and assess policy proposals. The first step in increasing independent participation is to allow restoration of a private, self-interested ethos in the existing and historical NGIs by removing all government presence and financing from them. Beyond that, governmental processes can be altered so as to allow these NGIs to effectively participate in the policymaking process. If meaningful participation is allowed, the number and professionalism of these NGIs will grow. It is not necessary to provide financing or other encouragement for these NGIs. If the NGIs are granted a significant role in policy making, they will expand and self-finance on their own. There is clear evidence that the expanded role of these NIGs in the economy is markedly beneficial to growth in GDP, employment and productivity.²⁰

6.4 **B** Broaden the Domestic Tax and Borrowing Base Tax-payers and government debt-holders ("citizen creditors") have an increased stake in the government, which in turn has an increased stake in them. This is an old theme, most notably set out by Alexander Hamilton in the US Federalist Papers in 1789. In general, the greater the recognition of the inter-dependency between governments and private commercial activity for revenue and borrowing, the greater is "participation" in PBL activities. The theme of broadening the domestic responsibility for government revenue provision to expand participation has been given new impetus in a book by James Macdonald.²¹ Regarding participation, the following quote might well sum up the view in Macdonald's book by the following quote regarding England in the 1700s: "...England is a country, like the Dutch Republic, where the finances are absolutely governed by those [citizens] who furnish them."²²

6.5 Viewed from the perspective of citizen participation, the best fiscal policy is the one that maximizes the number of taxpayers and domestic government debt holders (citizen creditors). Lower amounts of taxes collected from many citizens and enterprises/farmers are better than higher tax collections garnered from the few. This seems counterintuitive to governments minimize both the number and cost of collecting target amounts of revenue from domestic sources. This leads to unwise behavior in that it rationalize excessive reliance on granting monopoly protection to generate super normal profits, albeit on smaller output levels, by a few firms that are easily taxed. Rarely considered is the fact that extra collection efforts and costs can expand participation and policy ownership and effectiveness. This is turn will increase economic growth and tax/borrowing revenue in the medium-term while also enhancing enterprise competition. Such competition is the sine qua non of technical change and innovation and, therefore,

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²¹ James Macdonald, A Free Nation Deep in Debt: The Financial Roots of Democracy; Farrar, Straus & Giroux, New York, 2003, 564 pp. The term "citizen creditors" is a Macdonald term.

²² Brackets [] added.

longer-term growth in GDP, employment, productivity and domestic government revenue and borrowing ability.

6.6 The fiscal elements of citizen participation suggest that PBL focus on increasing the number of tax-payers, importantly by lowering tax rates and exemptions and promoting competition, primarily through anti-trust activities (breaking up monopolies into competing enterprises) and easing entry for new investors. Ease of entry and exit and vibrant competition are conducive to increasing participation in the formal sector.

6.7 **C** The Significance of Informal Economic Activity A relatively large and vibrant informal economy is evidence of disinterest in, even avoidance of citizen participation. In fact, the relative rates of growth of the formal and informal sectors provides a good measure of the success or otherwise of governance initiatives. If the formal sector is growing in size relative to the informal sector, governance initiatives, which after all are targeted to the formal sector, are having positive effects. Even better would be a shrinkage of informal activity as participants there willingly migrate into the formal sector. On the other hand, if the informal sector grows, especially relative to the formal sector following governance initiatives, is most likely that the initiatives are poorly conceived and not effective.

VII. Legal & Judicial Reform

7.1 The focus of this reform effort is on four main areas as follows: 1) The Content and Completeness of the Legal Framework, including Laws, Regulations, etc., 2) The Judicial System that enforces the laws and regulations, 3) The Extent of Access to Justice, and 4) Law and Justice Institutions and Training. Over the years it has become clear that the better are a country's laws and judiciary, the better the chances for faster growth in GDP and poverty alleviation. In fact, growth in the legal and judicial systems represents growth in GDP since these are primarily service outputs that form an important component of GDP.

7.2 Studies show²³ that "big bang" Donor/government conceived and implemented legal and judicial reforms can fail. They require too many resources in too short a time and can alienate the citizenry, actually expanding, not contracting informal activity. Instead, successful legal and judicial reform efforts tend to be ongoing rather than once-and-for-all and are collaborative, involving both public and private, indigenous initiatives.²⁴ If collaborative and successful, the reforms will cause those engaged in "legitimate" informal activity to willingly amalgamate with and participate in the formal sector.

²³ Andrae Schliefer

²⁴ Examples include Southern African Legal Assistance Network (SALAN- See: <http://www.cba.org/CBA/IDP/SouthAfrica/Salan.asp> and IDC East Africa Program - See: <http://www.cba.org/CBA/IDP/Programs/EastAfrica.asp> .

7.3 It is important to remember that judiciaries and legal systems provide services that earn income for professionals/workers who provide inputs to faster economic development. As with other economic inputs, such as financial services, there is large scope for private entrepreneurial initiatives and income as long as legal and judiciary services are not constitutionally, politically or administratively reserved for government.

7.4 The parameters for a combined government, private (including foreign) and Donor legal and judicial reform initiative are as follows.

- a) Establish indigenous permanent group, consisting of sub-groups to write/rewrite/revise compendium of nation's laws, directives, etc. and to shepherd them through to final, official codification and publication (this is an on-going process). This group handles the conceptual and administrative aspects of codifying new developments in criminal, civil and commercial law and judicial procedures (e.g., bankruptcy, arbitration, etc.).
- b) Provide for the (adequate -- recurrent) budgetary, legal, political and administrative independence of judiciary.
- c) Obtain (capital) funding for building of adequate judicial infrastructure.
- d) Codify appropriate judicial procedures (this can have a large "copycat" element).
- e) Allow/encourage access to international legal and judicial service-providing entities primarily for reforms but also to operate (compete) in the domestic legal system. Donors, developing country bar associations and universities and private, non-profit organizations have a myriad of legal and judicial reform initiatives to provide expertise for reform and training.²⁵

7.5 As with each of the five governance issues considered here, there is a large volume of documents and web sites relevant to formulating country specific PBLs for legal and judicial reform. A good overview of such documents can be seen on a World Bank web site entitled, "Selected Documents from Other Organizations that Support Reform of Legal Institutions." See:
<http://www1.worldbank.org/publicsector/legal/otherdocs.htm> . An example of an assessment of a legal and judicial system is the United Nations, Commission on Human Rights Report for Mexico.²⁶ I reproduce the Recommendations of this report as **ANNEX 1** to this Note so as to show the sorts of concerns exhibited in a country legal and judiciary reform exercise.

²⁵ An excellent example is the American Bar Association's Central and Eastern European Legal Initiative (CEELI) for Eastern Europe. For training, see, Harvard's Kennedy School Program "Justice and Reform" at: <http://www.execprog.com/programs.asp?programid=130&displaymode=view> and the Dean Rusk Center International Judicial Training Program at: <http://www.uga.edu/ruskcenter/ijtp-mission.html> .

²⁶ United Nations, Economic and Social Council, HCR, E/CN.4/2002/72/Add.1, 24 January 2002

VIII Summary and Conclusions

8.1 This note examines what is involved in improving governance in Africa using Policy-Based Lending (PBL). PBLs provide budgetary support to governments while asking them to change or adopt policies that affect a country's incentive system so as to change the behavior of private citizens. Concerning governance, the issue is to change incentives and private behavior so as to improve governance. The African Development Bank (AfDB) has narrowed its governance purview to coverage of the five areas of **Accountability, Transparency, Combating Corruption, Increasing Participation and Legal and Judicial Reform and Access**. Much of the note focuses on issues relating to PBL governance initiatives in these five areas.

8.2 Concern for improving governance is the newest additional MDB initiative in PBLs and is the first such addition to be transparently covered on the internet. As a result, this note contains several, but only a few of the internet references relevant to the addition of governance initiatives to PBLs. However, since each web reference has copious links, the reader can effectively gain comprehensive coverage of the topic by following up on the references in the footnotes and on the links each contains.

8.3 Because PBL governance initiatives are relatively new, two issues stand out and are addressed here. One concerns the rationale for and essence of PBL governance initiatives. The other relates to mainstreaming concerns and capabilities for PBL governance initiatives into AfDB. The rationale is relatively straightforward: such initiatives can increase GDP and poverty alleviation directly, and also indirectly by increasing the impact of PBL initiatives in other areas such as liberalization of trade and privatization, etc. PBL governance initiatives accomplish this by incentive changes that encourage private enterprise to become involved in performing governance functions. The PBL approach to improving governance is thus focused as much on private and citizen enterprise (for-profit, non-profit and community based institutions) as it is on the public sector. This note labels these institutions Non-Government Institutions (NGIs) and distinguishes them from NGOs because they are indigenous and concerned with earning income as a result of what they do. To a significant extent NGIs are involved directly or indirectly with the provision of professional services, e.g., for the media, or the judiciary, or for economic policy, etc. Sometimes foreign professions are employed, but they work for and are paid by the NGIs, not the public sector.

8.4 Mainstreaming concerns and capabilities amongst staff concerned with PBL operations is crucial if PBL governance initiatives are to effectively added to the Bank's PBL arsenal. This note raises this issue but deals with it rather cursorily and abstractly. The guidelines must deal with it too. Given AfDB's unique position in Africa, it makes sense that Bank staff take a leadership role in PBL governance initiatives amongst other MDB and Donors. In view of the fact that many PBLs are jointly prepared, with one agreed-on policy framework, effective mainstreaming coupled with proper training and resource allotments will enable Bank staff to take and excel in such a leadership role.

8.5 The note is positive concerning AfDB's proactive position regarding adding governance initiatives to its PBL arsenal. Although a new area, in which experience and successes are limited, a priori or deductive reasoning suggests that weak governance is indeed a binding constraint on adjustment success in most African countries. Such reasoning suggests that governments have in the past tried to take on too much and have "crowded out" private initiatives that are crucial to improving governance. A crucial element of all PBL governance initiatives is "right sizing" public sectors. For the most part, at present in most African countries, this means adopting governance initiatives that allow private initiatives to flourish and grow in volume compared to the public sector. Past PBL initiatives, notably privatization, and public expenditure controls have aimed at directly cutting the size of the public sector. Other initiatives have stressed rationalizing and/or improving its performance. Governance initiatives are somewhat different in that they are directed mainly at encouraging private citizens to form non-government institutions that will give them a greater voice and role in improving governance. This is a bold step, but one that Africa is ripe to benefit from.

ANNEX 1
**UN HCR Recommendations Regarding Legal and
Judicial Reform in Mexico**

Among the Special Rapporteur's recommendations are:

- (A) 1. A fixed percentage of the federal budget should be annually allocated for the judiciary.
2. The supremacy of international treaties signed and ratified by the Government over domestic laws should be entrenched in the Constitution.
3. The Constitution should also provide that recommendations of national and State human rights commissions are binding on all authorities, including the Federal Government.
4. States should provide in their respective constitutions for the allocation of a fixed percentage of the budget to the judiciary, full security of tenure for judges at all levels and the establishment of judicial councils;
- (B) With regard to the judiciary:
1. An evaluation must be undertaken of the number of courts needed, both at the federal and State levels, to meet the needs of the people for access to justice;
2. In the evaluation of judicial appointments and continued legal education for judges emphasis must be given to international human rights standards and norms, including fair trial procedures.
3. The processes of judicial appointments at all levels must be made transparent;
4. In order to maintain its independence and integrity the judiciary must be provided with the power, the machinery and the resources to enforce its own judgements.
5. Texts of laws and judgements of superior courts should be readily to all involved in the administration of justice;
6. A uniform code of ethics for magistrates and judges at all levels should be produced and published;
7. In order to address judicial corruption consideration could be given for all magistrates and judges to declare their assets to the Judicial Council at the time of appointment and periodically thereafter.
- (C) The Judicial Council must conduct its affairs independently of the Supreme Court and the other branches of government. Disciplinary proceedings must be transparent and conform with the Basic Principles on the Independence of the Judiciary;
- (D) 1. Crimes alleged to be committed by the military against civilians should be investigated by civilian authorities to allay suspicions of bias.
2. Current legislation should be amended to provide for the civil judiciary to try members of the military accused of committing specific crimes of a serious nature against civilians, outside the line of duty.
3. Urgent consideration should be given to removing the military from the policing of public law and order in society;

(E) The process of removing incompetent and inefficient personnel from the Public Prosecutor's Office must be intensified to gain public confidence;

(F) Public Defenders should be made independent of the executive. They must be adequately remunerated and given a manageable workload. They should be licensed lawyers and should be given adequate training;

(G) 1. The Government should undertake without delay a study of the system of legal education and qualification for the legal profession, both at the federal and State levels.
2. An independent mechanism or institution composed of judges, lawyers, academics and representatives of the Public Prosecutor's Office should monitor and administer uniform criteria for qualification to practice.
3. Legislation should provide for a self-governing and self-regulating Bar association at both the federal and State levels.
4. There must be a uniform code of ethics for the profession, enforceable by a self-disciplining mechanism established by law;

(H) 1. All human rights violations, including allegations of widespread corruption, including some high profile cases, need investigation and public accountability.
2. Those known to have committed human rights violations should be removed from public office;

(I) Police and prison authorities must respect the rights of detainees to have access to lawyers;

(J) The Government must provide adequate protection to lawyers and human rights defenders against all forms of threat, harassment and intimidation. Reports of threats, harassment and intimidation must be thoroughly investigated and the perpetrators brought to justice;

(K) With regard to fair trial procedures:

1. Government should ensure that confessions obtained by force cannot be used as evidence in trial proceedings
2. Statements made by detainees should not be considered as having probative value unless made before a judge.
3. All complaints of torture should be duly investigated and the perpetrators should be prosecuted.
4. The Government should reopen all cases where there are serious grounds to believe that persons were convicted on the basis of confessions which were obtained by force.
5. The practice of judges delegating secretaries to record evidence should be discontinued.
6. The practice of conducting court proceedings in maximum security prisons should be discontinued.

(L) There should be a review of the amparo procedure with a view to making it less

costly, simpler, speedier and more effective;

(M) The Government should examine the possibility of guaranteeing the independence of labor boards and agricultural tribunals and integrating them into the judicial power;

(N) The agreements on the rights and culture of the indigenous people signed by the Government and the Zapatista National Liberation Army (EZLN) should be implemented and indigenous traditions and law should be recognized to the extent that they do not conflict with the main legal system. In the case of non-Spanish-speaking indigenous accused persons appearing before the courts, the presence and assistance of a qualified interpreter needs to be guaranteed. Immediate measures should be taken to abolish slavery-like working conditions for indigenous immigrants;

(O) The Law on the Protection of the Rights of Girls, Boys and Adolescents should be implemented without delay. Independent courts must be set up to deal with all juvenile cases;

(P) Women

1. All unsolved murders of women should be thoroughly investigated and the perpetrators brought to justice.
2. Discriminatory practices against women in the workplace should be eliminated.
3. Programs should be developed to enhance access to justice for women.

ANNEX 2

COLLECTING DATA FOR COUNTRY-SPECIFIC PBL ASSESSMENT OF GOVERNANCE

II-1. The general parameters for PBLs for improving Governance are similar for all countries in Africa. However, country-specific PBLs must reflect the governance situation in particular countries. This ANNEX addresses the issue of how to determine these country-specific governance parameters using independently collected information and data available on or through the web. It is expected that collecting these data for country-by-country will indicate how governance PBLs can best be designed in specific country circumstances. This ANNEX can be viewed as reference note that allows the designers of PBLs to tailor governance PBLs to country-specific circumstances. A computer program for making a complete but somewhat confining country-specific governance inventory ("AFRICA GOVERNANCE INVENTORY") can be obtained from the UNDP.²⁷

II-2. Many of the country specific governance measures available on the web do not map exactly into AfDB's five categories. Indeed virtually all encompass several of the five as well as other measures of governance as well. Below are listed several of these "omnibus" measures that can be used in addition to applicable country-specific knowledge to design PBLs for governance. Of course not all African countries will be "measured" by all the indexes.

II-3. Indices of Economic Freedom Several prominent governance experts use the Freedom House index²⁸ to gain an impression of the extent of freedom in countries. However, this index uses relatively more political and fewer economic freedom indicators. For this reason, the Fraser Institute's "FREEDOM OF THE WORLD" data are preferable if the country coverage is appropriate.²⁹ This index, though good, doesn't cover many African countries. For that reason it is useful to list the elements of the index so that they can be taken into consideration in the design of country-specific governance PBLs. Here is a listing of the components and sub-components.³⁰ These are displayed to a) show what is important in strengthening civil enterprise and b) so that a rough assessment of a country's initial conditions can be made in cases where this index is not calculated.

1. Size of Government: Expenditures, Taxes, and Enterprises
 - A General government consumption spending as a percentage of total consumption (lower = better)
 - B Transfers and subsidies as a percentage of GDP (lower = better)
 - C Government enterprises and investment as a percentage of GDP (lower = better)

²⁷ Go to the following web site:

<http://unpan1.un.org/intradoc/groups/public/documents/un/unpan006877.pdf> .

²⁸ Available country by country on: <http://www.freedomhouse.org/ratings/index.htm>

²⁹ These are available country-by-country at: <http://www.freetheworld.com/download.html>

³⁰ These can be found in: <http://www.freetheworld.com/2003/1EFW2003ch1.pdf>

- D Top marginal tax rate (and income threshold at which it applies) (lower = better)
- 2. Legal Structure and Security of Property Rights
 - A Judicial independence. The judiciary is independent and not subject to interference by the government or parties in disputes
 - B Impartial courts: a trusted legal framework exists for private businesses to challenge the legality of government actions or regulation
 - C Protection of intellectual property
 - D Military interference in rule of law and the political process
 - E Integrity of the legal system
- 3. Access to Sound Money
 - A Average annual growth of the money supply in the last five years minus average annual growth of real GDP in the last ten years
 - B Standard inflation variability in the last five years
 - C Recent inflation rate
 - D Freedom to own foreign currency bank accounts domestically and abroad
- 4. Freedom to Exchange with Foreigners
 - A Taxes on international trade (Ave. Trade Tax Rate; St. Deviation of Rates)
 - B Regulatory (Non-Tariff) Trade Barriers (exist/don't exist & cost as % trade volumes)
 - C Actual size of trade sector compared to expected size
 - D Difference between official exchange rate and black market rate
 - E International capital market controls
 - i Access of citizens to foreign capital markets and foreign access to domestic capital markets
 - ii Restrictions on the freedom of citizens to engage in capital market exchange with foreigners -- index of capital controls among 13 IMF categories
- 5. Regulation of Credit, Labor, and Business
 - A Credit Market Regulations
 - i Ownership of banks: percentage of deposits held in privately owned banks
 - ii Competition: domestic banks face competition from foreign banks
 - iii Extension of credit: percentage of credit extended to private sector
 - iv Avoidance of interest rate controls and regulations that lead to negative real interest rates
 - v Interest rate controls: interest rate controls on bank deposits and/or loans are freely determined by the market
 - B Labor Market Regulations
 - i Impact of minimum wage: the minimum wage, set by law, has little impact on wages because it is too low or not obeyed
 - ii Hiring and firing practices: hiring and firing practices of companies are determined by private contract
 - iii Share of labor force whose wages are set by centralized (i.e., govt.) collective bargaining
 - iv Unemployment Benefits: the unemployment benefits system preserves the incentive to work
 - v Use of conscripts to obtain military personnel
 - C Business Regulations
 - i Price controls: extent to which businesses are free to set their own prices
 - ii Administrative conditions and new businesses. Procedures are an important obstacle to starting a new business
 - iii Time with government bureaucracy. Senior management spends a substantial amount of time dealing with government bureaucracy

- iv Starting a new business: starting a new business is generally easy
- v Irregular payments: irregular, additional payments connected with import and export permits, business licenses, exchange controls, tax assessments, police protection, or loan applications very rare

II-4. More specific information on how greater economic freedom (i.e., a better freedom index number) fosters faster economic development and poverty alleviation can be appreciated by reading a paper by Simeon Djankov (et al), entitled "The Regulation of Entry."³¹ In essence, more economic freedom allows/encourages more investors/entrepreneurs to start or buy businesses, thus increasing the volume of private investment and employment and competition within the country.

II-3. Business Environment Risk Intelligence³² The Business Risk Service, part of BERI S.A. measures three main components of the business risk atmosphere. One is the Operations Risk Index that measures the extent of major bottlenecks in business operations. Another is the Political Risk Index that measures the sociopolitical conditions (superior to unacceptable) in 50 countries (a few in Africa). And finally there is a separate measure of how the country treats foreign investors with respect to various things such as ease of importing and exporting and repatriation of profits.

II-4. Country Risk Ratings In 1996 Data Resources International and Standard and Poors developed these ratings for foreign investors. In March 2001 these ratings were taken over by Global Insight.³³ Unfortunately they are no longer free. However, they are important because of their coverage of governance issues and of countries. These ratings cover 33 immediate risk events as follows:

- * tax rates (corporate, import, etc.)
- * foreign ownership rights
- * exchange rate depreciation/appreciation
- * financial default
- * fund transfer
- * infrastructure disruption
- * physical hazards

- * contract enforceability
- * regulations (environmental, etc.)
- * costs (labour, construction, etc.)
- * domestic demand growth
- * trade sanctions and conflict

³¹ This is available at: http://econ.worldbank.org/files/2379_wps2661.pdf

³² See: <http://www.beri.com/>

³³ Go to: <http://www.sovereign-publications.com/globalinsight.htm>

- * crime and corruption
- * skill shortages.

ANNEX 3

Examples of Project Preparation for Governance

A. Ten steps for designing Community Driven Development (CDD) projects.³⁴

Principles for supporting sustainable and effective CDD:

1. Establish an enabling environment through relevant institutional and policy reform
2. Make investments responsive to informed demand
3. Build participatory mechanisms for community control and stakeholder involvement
4. Ensure social and gender inclusion
5. Invest in capacity building of CBOs
6. Facilitate community access to information
7. Develop simple rules and strong incentives, supported by monitoring and evaluation.
8. Maintain flexibility in design of arrangements
9. Design for scaling up
10. Invest in an exit strategy.

B. Constructing Country Specific Baseline Data on Governance

An efficient way to get baseline data on governance indicators for specific countries is to use the World Bank's Governance Indicators that can be found on: <http://www.worldbank.org/wbi/governance/govdata2002/> . This site presents aggregate governance research indicators for almost 200 countries for 1996–2002, for six dimensions of governance:

- * Voice and Accountability
- * Political Stability and Absence of Violence
- * Government Effectiveness
- * Regulatory Quality
- * Rule of Law
- * Control of Corruption

³⁴ From:

<http://lnweb18.worldbank.org/ESSD/sdvext.nsf/09ByDocName/ProjectPreparationImplementationKeyDesignPrinciples>

ANNEX IV

Major Best Practices Initiatives for Governance-Improving PBLs

IV-1. The five AfDB selected areas of governance are not totally distinct. Headway in one area also improves the others. However, initial conditions with respect to governance will vary from country to country. Some will be relatively good with respect to some of the five areas and relatively poor with respect to others. Because of this, the distinction of the five areas is preserved in the discussion of Best Practices below.

IV-2. **Across-the Board PBL Reforms** 1) Governance Surveys and Diagnosis: The first step is to chronicle all the available independent, country-specific assessments/ratings. Information gaps and shortcomings may need to be filled with diagnostic surveys. 2) Public Sector administrative/procedural reforms (in Africa this is frequently "Parastatal and Public sector Reform"). 3) Improve the business environment to encourage growth in the **number of** non-profit and for-profit non-government enterprises. 4) Tax reform. 5) Economic liberalization to increase competition through privatization and growth in private over public enterprise, anti-trust activities and freeing up domestic and foreign trade and formal/informal sector economic and financial interactions.

IV-3. **Reducing Corruption** Greater transparency and accountability are significant handmaidens in reducing corruption. Assuming initiatives in these areas are also undertaken, if needed, major activities are: 1) Raise wages and productivity by reducing the number of public sector workers while keeping the public sector wage bill constant. This is most frequently done through civil service reform. 2) Reduce the "reach" of the public sector (i.e., deregulate). 3) Adopt laws and regulations defining corrupt behavior and establish effective anti-corruption police and judicial units. 4) Develop/Publicize Formulate and adopt new procurement Procedures that encourage competition, openness and accountability.

IV-4. **Increasing Accountability** Greater transparency is also crucial for greater accountability. However there are some rather specific 1) Clearly specify and publicize the duties and expected outcomes (the "schedules") of public service positions. This is usually done as part of civil service reform and usually involves shedding "ghost workers" and reducing the number of Central Government public sector employees. 2) Implement Public Expenditure Management (PEM -- this includes budget reforms). 3) Decentralization and devolution of public sector responsibilities (including some taxing authorities).

IV-4. **Transparency** Greater openness and publicity is primarily a private sector function. An unfettered flow of information is needed to make markets work better and to improve governance. Transparency is crucial to exposing corruption and increasing accountability and civilian participation in governance. In most African countries there is no free press and no easy access to information. In fact, perversely, there is general acceptance of the view that governments should tightly control information flows. Even worse, there is a perception that costs of gathering and publishing information about

public sector behavior and policies is foolish compared to other capital and recurrent development expenditure needs. This is not so: such information stimulates the emergence of new private entrepreneurial activities and the accompanying financing resources. 1) Publicize a detailed program of reductions in secrecy. 2) Increase staff and expenditures for enlarged/new programs for making information (accounts, statistics, annual reports, etc.) publicly available quickly. 3) Deregulate to allow emergence of free press and other information-related NGIs.

IV-5. **Participation** 1) Announce a strategy of expanding the domestic resource (tax and borrowing) bases in order to replace government revenue obtained from abroad. 2) Expand and increase the security of private property rights and allow unfettered trade in assets and foreign exchange (create/expand free asset markets) 3) Decentralization.

IV-6. **Legal and Judicial Reform** 1) Regulatory Reform (Deregulation and refocusing regulation). 2) Reforming/restructuring and expanding an independent judicial system. 3) Adopt/publicize new judicial code of ethics and strengthening judicial enforcement. 4) Legal (services) education and training.

ANNEX V

Mainstreaming Governance Activities³⁵ into AfDB PBL Work

V-1. The lessons of other MDBs has been that unique efforts and separate budgets are needed to successfully integrate (mainstream) governance-improving activities into PBL operations. Two such emphases relate to sensitizing and familiarizing AfDB operations staff on the one hand and then their government counterparts on the other hand with the importance, essence and content of governance improving initiatives. Conceptually these are two separate initiatives. However, crucial in both is to convince the parties of the importance and benefits derivable from the growth in the number and diversity of Non-Government Institutions (NGIs).

V-2. As it turns out, there is sufficient overlap that the World Bank has learned that it makes sense to combine the training, awareness and sensitivity building for MDB staff and client government personnel. This task has been allocated to the World Bank Institute (WBI), which runs governance training and sensitivity courses open to both MBD operations staff and their government counterparts.³⁶ There are considerable benefits and economies to AfDB in using the World Bank's WBI courses rather than mounting it's own. However, there are heightened coordination problems associated with this approach. A decision to use WBI should be preceded by considerable discussions with those in WBI involved with this effort.³⁷

V-3. The third discrete emphasis requires AfDB operations staff to broaden their familiarity and contacts with nascent, numerically expanding number of NGIs. This is a time-consuming and unfamiliar task for operations staff used to dealing with carefully proscribed government counterparts. In fact, AfDB operations staff are well placed to successfully undertake this task, but at present neither they, nor their client governments are naturally disposed to go beyond fairly tightly circumscribed contacts. Among other things, this results from the very penchant for secrecy that governance initiatives aim to reduce.

³⁵ A major consideration of this topic is "Mainstreaming Anti-Corruption Activities in World Bank Assistance: A Review of Progress Since 1997." The paper, whose main author was Anwar Shaw in OED, is not officially available and can not be quoted.

³⁶ To see the course offerings go to: <http://www.worldbank.org/wbi/governance/programs.html> and select (click on) the area of interest to see course offerings.

³⁷ A good person to contact to start these discussions is Mr. Dani Kaufmann: dkaufmann@worldbank.org